How to Avoid Losses in Your Investing

This is the Law of Business, that
only the Strong shall thrive;
That surely the Weak shall perish,
and only the Fit survive.
When all your shekels are taken,
you are numbered among the
Slain,
This is the Will of Business,—
Lo, how she makes it plain!

(With apologies to Robert W. Service)

Finance Publishing Syndicate
240 W. 14th Street, New York

PRICE, $1.00

Finance Publishing Syndicate
240 W. 14th Street
New York

CONTENTS

CHAPTER I

CHAPTER II

CHAPTER III

CHAPTER IV

CHAPTER V

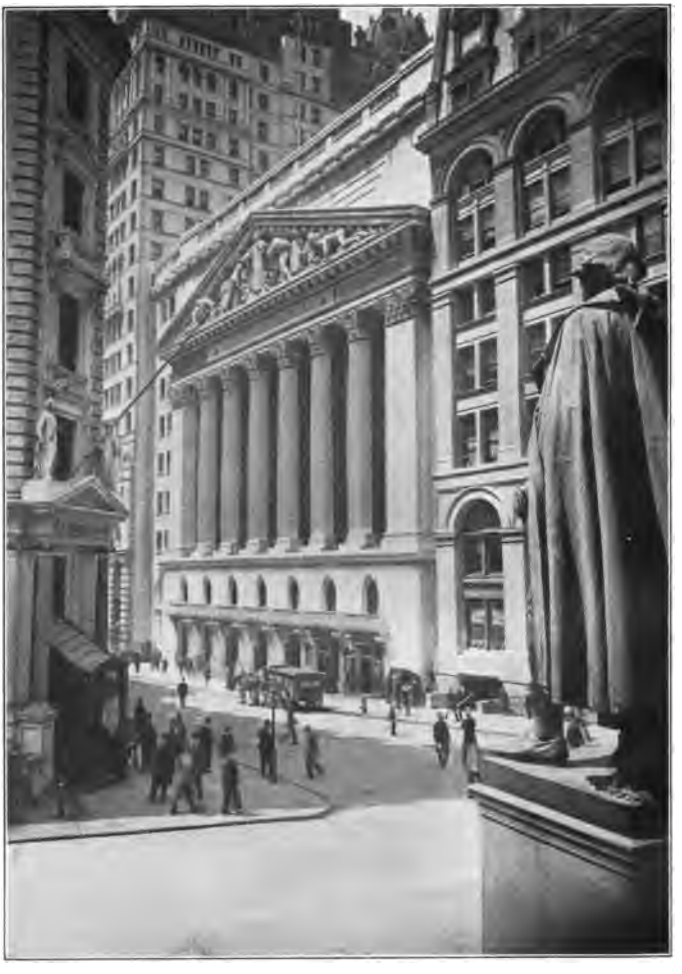
CHAPTER VI

CHAPTER VII

CHAPTER XI

CHAPTER XII

ILLUSTRATIONS



THE NEW YORK STOCK EXCHANGE WITH THE OLD J. P. MORGAN & CO. BUILDING TO THE LEFT ON CORNER

How to Avoid Losses in Your Investing

CHAPTER I

The Great Security Market

As noble and stately a looking building as is to be found in the financial district of New York houses the great United States mart for the buying and selling of securities—the NEW YORK STOCK EXCHANGE—the front and main entrance to which is situated, not on Wall street, but on Broad street, New York City. Patterned after it are others, of which the Philadelphia Stock Exchange is an example. These exchanges permit trading in only such securities as have passed a very careful scrutiny as to their soundness and merit. It can safely be said that under ordinary conditions all stocks listed on these exchanges have behind them real intrinsic values somewhat in proportion to the prices at which they are quoted. It is frequently the case that, due to manipulation or a public demand that does not take into consideration their just values, many of these stocks sell at times for prices much in excess of what they are worth, but, on the other hand, it is no uncommon thing to find stocks whose prices are considerably below what their assets and earning powers should call for.

Abuses

In the past many and flagrant were the abuses to which the investing public was subjected by the manipula-

fact that he can do this on margin, *i. e.*, the putting up of only a small part of the price at which he buys the stock, permits him to handle a greater number of shares, and, if he is successful, his winnings are naturally greater than if he were forced to buy outright. I am not writing a treatise on morals, so the question of the right or wrong of speculating in stocks on margin is not at issue. Provided the speculator can afford to lose the money he puts up, not much material harm is done to him.

Worthless Securities Traded In

I have said before that the New York and like stock exchanges cause a careful investigation to be made into the merits of a stock before it can be listed. This, in so far as it is humanly possible, safeguards the genuine investor against buying a something that has no value. Unfortunately, there are other exchanges for the buying and selling of securities that have not been so careful. The result has been that many worthless securities have been foisted on the public to its great loss. So scandalous during the past two years were many of the oil-promotions, whose stocks were traded in on the New York Curb, that pressure was brought to bear on the brokers, urging them to investigate carefully any issues traded in. The harvest was so great that the number of traders or brokers in the open market on Broad street, New York, where the New York Curb Association does business, increased by hundreds and all kinds of wildcat stocks were sold and bought and are now held by the public at great loss to the investors.

THE NEW YORK CURB MARKET ON BROAD STREET JUST BELOW THE NEW YORK STOCK EXCHANGE

Note the men in the windows communicating by sign language with the brokers' representatives on the street

New York Stock Exchange is touched by

CHAPTER II

The Broker

Webster defines a broker as "One who buys and sells for others, especially, stocks and securities." The broker who honestly fulfills the functions of his calling, keeping in mind always the best interests of his customers, is a requisite and valuable member of the business community. Of necessity he acquires an intimate knowledge of securities, which knowledge, properly used, can be of inestimable value to those of his customers who apply to him for it. There are such brokers, and they have an established clientele whose business they keep right along. On the other hand there are many others, and the woods (I mean the cities) are full of them, who, availing themselves of a profound insight into human nature, exploit the weaknesses of their customers, the public, to their, the brokers' own advantage. These men are in business exclusively to make money for themselves, no matter who loses. The lists of their customers are constantly changing because the basic principle of serving the customers' best interests is not adhered to. The constant loss of clients does not worry them. They know how to get more. They know the speculative blood is rampant in mankind, and that there is an unending flow of people ever ready, hopeful of making easy and quick money. Long experience has taught them that the average stock speculator in the long run almost always loses. If you will think for a moment it is not difficult to undertsand. What does the ordinary speculator know about the stocks he is buying on margin or outright? In reality, practically nothing, except what the broker tells

him. What does the average broker or the customer know about the future trend of the market? Nothing, but the customer believes the broker does, and he swallows the broker's suggestions, which are always carefully qualified by such sonorous phrases as, "In my opinion," "I have reason to believe," "It would appear to me there is every evidence," "I am creditably informed that strong interests will take hold" and that "such and such a stock or stocks should have a rally of proportions." Occasionally the broker is right, more often he is wrong. In either event it is immaterial to him provided the customer buys *on margin.* Why? The broker knows the great mass of the public that dabbles in stocks always buys on the assumption that the market will advance, and he knows, furthermore, that no matter how great the advance there is always a decline coming. You will wonder, perhaps, how the broker, who is eager to have you buy on margin (of course he does not say this), benefits. I will leave you to form your own conclusions when you have finished reading this book and, if you do not know then, you had better continue buying on margin through such brokers until experience teaches you enough so that you will understand.

Brokers Know Margin Speculators' Minds

This type of broker, by long training, knows his business thoroughly. He is dealing with people few of whom know the art of speculation. He knows the processes of the speculator's mind down to the crossing of a 't" and the dotting of an "i," and many of them count on the fact that you do not know the processes of their minds, which you do not, or you would not so regularly and constantly lose your money. The broker knows that very, very few have the qualifications necessary to a successful stock speculator.

Many brokers have proven this to their loss and sorrow. On the "street" they can, if they will, tell you of brokers who, having made a fortune through you, thinking they know what the majority of speculators have proven they did not know, plunged heavily themselves on margin and paid the price of failure. They thought they knew when to buy and when to sell. They did not. The speculators who, staying in the game, have made money in stock speculation, due to the profound knowledge and experience and advice from the better class of brokers, are small in number, but the losers, their number is legion.

The Right Kind of Broker

From what has been said in the preceding paragraphs it is evident that there are two outstanding types of stock brokers who handle accounts in listed securities. One, the broker whose pride it is to attend to your business, protecting you always in so far as he can, and never suggesting that you do that which he would not do himself. He is the conservative, safe, upright type. You never see his name at the bottom of expensive, seductive, questionable advertising, in fact he advertises but little, perhaps just enough to keep his name before the public, unless he has something real which he has investigated thoroughly to present. It is relatively easy to pick him out. He is not swamping you with letters making all kinds of suggestions which he would have you believe would be to your advantage if acted on through him. If you buy securities, or if you must speculate, choose the broker who wants to help you make good, who would sooner not earn his commissions on your transactions than see you lose money. This kind of broker wants your investment business, but he does

not want it for a few months or a year, he wants it permanently because of your satisfaction with his services.

The Wrong Kind of Broker

The wrong kind of broker wants you to attend to his business. He is a very clever individual. You will see his advertising in every newspaper, journal or magazine he can get into that he thinks, to use an advertising term, "will pull." His advertising is as varied in kind as he is. Some of it is rank get-rich stuff, and some of it is, on the surface, essentially conservative in character. The latter is the really clever advertising. In it you are perhaps told that an analytical digest of United States Steel or Pennsylvania Railroad or some good sound security will be sent you upon request. Many readers think the advertiser would like them to invest in these stocks. Frequently the advertising broker is not a member of an exchange on which these stocks are listed and if you send him an order he has to place it with a broker who is. There is no commission in it for him presumably. What is his object? You will probably find it in his market letter or in the other letters he will no doubt send you, but it is not United States Steel nor Pennsylvania Railroad that he wants you to buy. These stocks are too stable.

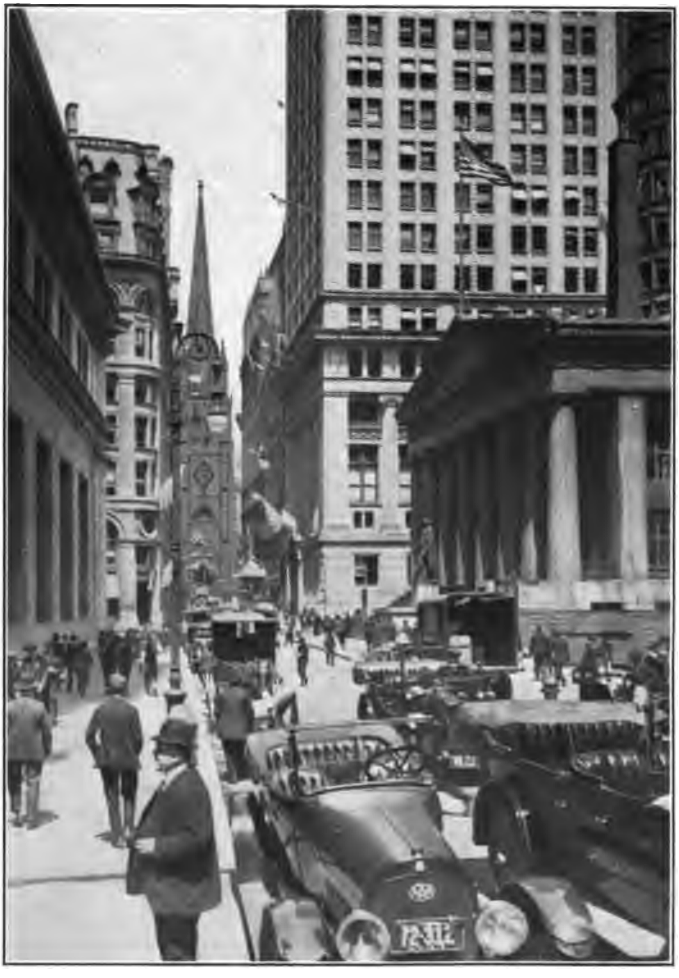
Mailing List, Market Letter, House-Organ.

This second kind of broker will promptly put you on his mailing list, and you will receive his market letter or newspaper (house-organ), and stacks of literature on oil, gold, silver, copper or industrial stocks that are listed on the Curb or some exchange. You will also be circularized regularly with carefully baited hints regarding the possibilities

for profit in this stock or the other. He wants you to buy and will tell you if you do not care to buy outright that certain stocks can be handled on margin. He will also, as he may have done already in his advertising, state that your account will receive his personal attention. Remember, you are a stranger to him, that he has hundreds, perhaps thousands, of ever-changing accounts in his office, and he won't know your's from Adam's unless you happen to be a "big fish." The volume of correspondence going out of his office is so great he may personally never see a letter that is written to you. He has a corps of able men who dictate your letters, and in all probability no one knows who signs them unless some particularly attractive or annoying possibility is in question.

Enormous Expenses and New Business

His expense account is enormous, consisting of payments for employees with salaries running as high as three figures weekly, offices at high rentals, commissions, advertising, printing, letter-heads, envelopes, postage, telephoning, telegraphing, etc. The object of his organization is business and new business to replace the lost and dead, and he gets it. You will receive pamphlets and booklets showing you how to trade in stocks and the profits you should make, but you seldom or ever make them in the long run. He knows the trend of your mind, and he has you on his list to attend to his business, to exploit you to the limit you will stand for his particular profit. If you want a broker keep away from this kind if you do not want your pocketbook to become so lean that it will hurt you.



Copyright by Underwood & Underwood, N. Y.

WALL STREET

J. P. Morgan & Co. to left—Old Trinity Church on Broadway—Bankers' Trust Building—Sub-treasury to right

CHAPTER III

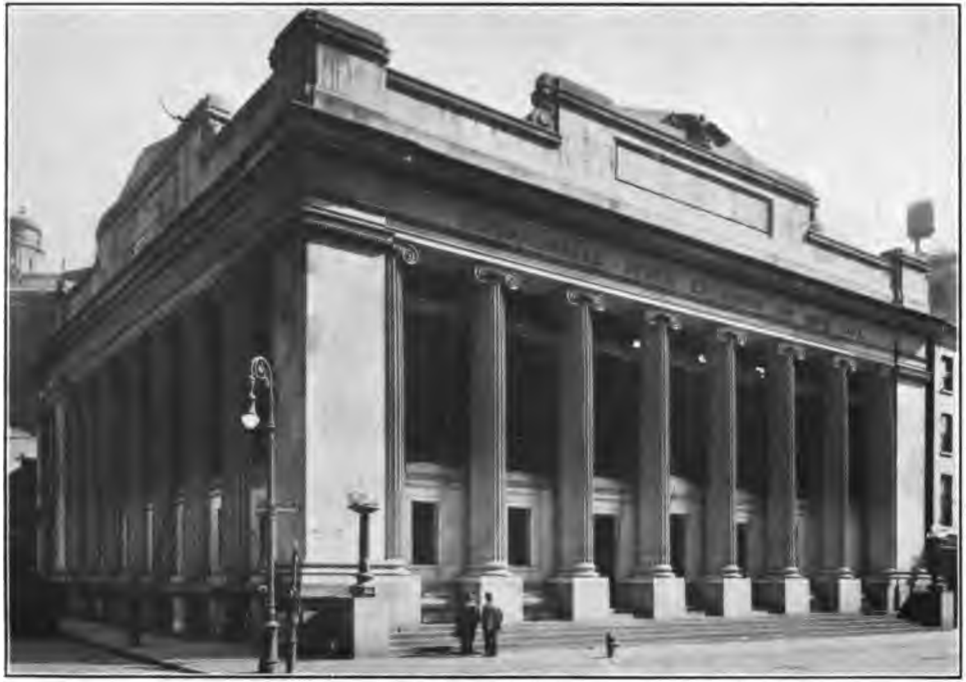
The Customer

The customer comes from every walk in life. You will find politicians, merchants, bankers, lawyers, doctors, clergymen, mechanics and clerks among them, and a goodly number of women. They patronize both kinds of brokers. Those who wish to make much money out of little patronize the second kind. The president or the cashier of your bank, your lawyer, doctor or clergyman may be among those taking a "flier." They will deny it because they don't want anyone except their broker to know. It is pitiful at times the way those people open their hearts to one who for the moment they trust—a truly queer kind of confidence. It is a case of the Wolf and the Lamb. A wolf may have been gorged to repletion and too lazy to kill the lamb, but certain brokers are never known to refuse an account, be it ever so small.

Thinking Processes of Margin Trader

The thinking processes of the speculating customer are peculiar. He is almost invariably on the long side of the market. His idea seems fixed that the market price of stock is bound to increase. For him, there is **no top** to the market. He is more likely to buy or increase his holdings after a big advance, and when the crest is being reached he is then buying in greater volume than ever. When the break comes he is surprised, and if he is carrying his stocks on margin puts up as long as he can, but when the decline is severe or continues long enough he inevitably

comes out on the debit side of the ledger. Very few of them put in stop loss orders, that is, instruetions if the stock declines to a certain figure to sell out, consequently, on a big recession in the market, the majority of the margin traders is caught short. He rarely learns after repeated losses that he cannot beat this angle of the game, being upheld by the same foolish optimism of the player who frequents a Monte Carlo.



CONSOLIDATED STOCK EXCHANGE, NEW YORK

CHAPTER IV

The Wrong Broker's Methods

The methods followed by the second class of brokers previously referred to are simple. His main object is to convince the customer of the possibilities of great profit in margin trading, and behind the mass of literature and correspondence he sends is that one undeviating purpose. From the moment a new customer has bought a stock or stocks he is the object of special attention. Recommendations are made to increase his present holdings or to add new ones that, "in the opinion of the broker," are due for an advance. The broker rather likes in the beginning to see the account of a new customer show a profit on his books. It appears so easy to the customer that orders for more stocks are generally forthcoming. He is encouraged to send all the cash he can, then one day he is likely to receive a letter on the following order:

DEAR MR. SMITH:—

In my personal letters to you and in my market letters I have pointed out the possibilities of a decided increase in the market values of the following stocks (mentioning several). Since drawing your attention to them their quotations have advanced from 2 to 10 points, with every indication of further gains in the near future. It would certainly have been to your advantage had you instructed me to buy when they were first drawn to your attention. I still believe there will be a material advance in these issues, and urge that you avail yourself of this profit-making opportunity.

In looking over your account I notice that you have an excess margin of five hundred dollars which could be used to advantage by the purchase of about 200 shares of each at present quotations and still leave your account amply protected. Should you care to purchase in excess of the above I will be glad to receive your check covering the amount you desire.

Send me your order at the market, and it will receive my prompt attention.

Thanking you for the business with which you have already favored me, and assuring you of my desire always to be of service, I am, etc.

How Your Money Is Lost

Have you ever received or seen such a letter as the one in the preceding paragraph? More often than not the customer comes through. He has made easy money and his appetite is whetted for more. On a long-continued advance his profit might grow to quite respectable figures. Meantime the broker never lets up in his suggestions to use his excess profit for the purchase of additional stocks. When the crest of the market is passed and the decline takes place he finds himself long an amount of stock he never would have thought of taking on at one time. If he has followed his broker's suggestions he also finds that he has little or no excess margin when the inevitable break in prices comes and, with it, the call for more money to properly margin his account. Sometimes, if the break in prices is great enough, he is wiped out entirely. Generally speaking, if he only knew it, that might be the best thing that could happen to him. His losses would stop right there, at least on that transaction. Unfortunately for the customer he may not be wiped out, and encouraged by the

broker's statement that the market is only suffering from a temporary set-back, he sends the funds needed. The market is like the tides of the sea. When it has reached the full it goes to the ebb with recurrences of seeming strength apparently indicating another upturn. During the ebb in prices the customer is almost certain to forward money to the broker as long as he can, hoping each remittance is the last. His ready cash gone he gives instructions to sell part of his stocks and keeps this up to the last, or nearly the last, in which event he may find himself in possession of a few shares of stock that have cost him very dear indeed. Taking into consideration the full amount of money he has put up and the market value of the stock he has saved from his holdings, if any, he can easily figure out his losses.

Artificial Obstacles to Hold Money and Customers

In every rise in the market an occasional speculator sells out at a profit before it is too late, but, having made money once that way, he is sure to go back again and in time he is caught with losses he can ill afford. If perchance he has been lucky enough to decide to close out when he is ahead of the game it does not follow that his troubles are over. I have said before the broker has studied the mental processes of his customer. Some brokers delay and delay the final settlement, meantime sending suggestion after suggestion to the customer hoping some will take root and he will decide to re-enter the market. If he does all is well for the broker, if not, the delays of settlement are apt to continue. They vary according to the circumstance. If the customer has ordered the sale of his stocks at certain prices the broker may claim difficulty to sell at that figure even though the sales for the day indicate transactions at or above the price limit. Should the customer observe this he

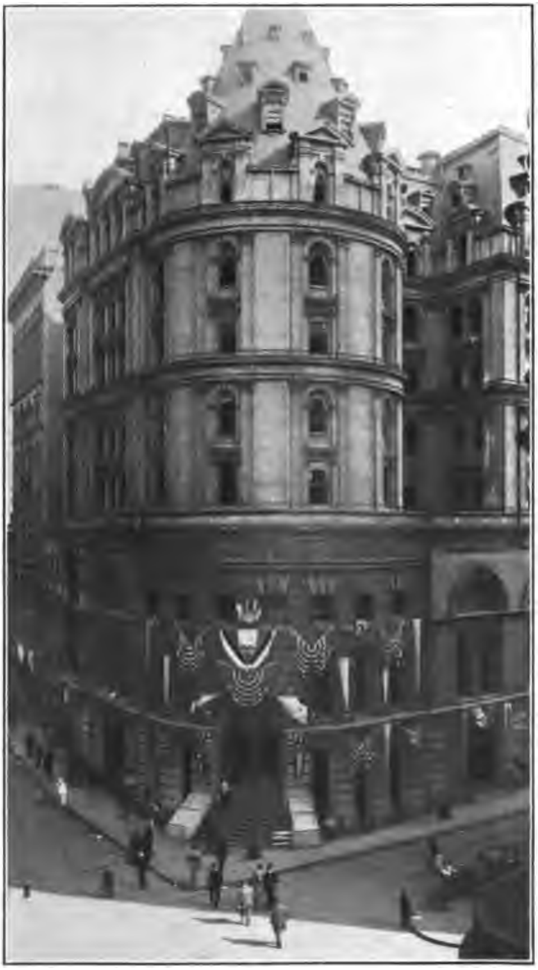
is apt to be told the absorptive power of the market in that particular stock is restricted and he was unable to place the stock and so on. Anything to keep the account on the books in the hope the customer will countermand his order is often the rule. It may be that the customer will decide to pay up his balance and take delivery of his stocks or give orders to sell part and retain the rest. There may then be repeated delays in delivery. If the broker has the stocks the transfer office of the company of a particular stock can be blamed for slowness in making the transfer. Rush of business or distance makes a good excuse for this. In any event many a customer has become exasperated at the delays and only gotten his money or his stocks after calling in his lawyer.

Results to Brokers

The success of the method of certain brokers outlined above is perhaps best illustrated by the words of a man who has been in the financial district of New York for many years. He was talking about the enormous amount of business done after a long period of advances in the market by brokers in the Wall Street district and referring to the evidences of wealth shown by those who handle Curb and outside stocks. It was after one or two heavy breaks in the Curb market. His words were:

"This break has been a lucky thing for many of the houses down here. If the market had continued its upward trend more than one of them would have had to close their doors. I wonder how many margin calls have been sent out lately and how many accounts have been wiped out."

When you are through reading what is written between the covers of this book the inference ought to be clear enough to warn you that there is one way not to buv stocks.



Copyright by Underwood & Underwood, N. Y.

COTTON EXCHANGE, NEW YORK

CHAPTER V

Fishers of Men

In the nineteenth verse of the fourth chapter of St. Matthew is to be found the saying of Jesus to Simon and Andrew: "Follow me, and I will make you fishers of men." "Fishers of men" for men's good.

The financial world has many "Fishers of men" of the wrong kind—"Fishers of men" who make it their business to get as many as possible in their carefully placed nets, not with the object of doing good but to relieve them of their money, and, when they have cleaned-out and skinned their catch, throw them back into the sea of despair.

The words "fisher" and "net" bring to mind the great nets or fish-traps used by fishermen. Their construction is simple. A narrow, hall-like entrance, always wide open, into a great square room. The fish pass through the entrance into the roomy, inside square of the net and, curiously, there they stay swimming round and round, never thinking to go out the way they came in, until the fisherman hauls the net in, fish and all. Too late then for the fish to escape.

Clever brokers of the wrong kind referred to previously have been known to compare margin-traders to fish. Margin-traders enter the margin-trading net and it is a remarkable psychological fact they seldom think to get out before it is too late.

A few Suggestions in the Form of Questions

1. Have you ever wondered, if you are a small investor with only a few tens or hundreds of dollars to play

with, why certain brokers are so anxious to get your account?

2. Provided you did not write direct to the broker have you ever suspected how he secured your name and address?

3. Have you ever thought how the broker pays his enormous expenses for offices, salaries, commissions, advertising, printing, telegraph and telephone lines, etc.?

4. Have you ever kept track of the records of sales on the New York Curb? If so, has it ever struck you to try and figure out the approximate earnings of brokers on commissions? If you have done this have you ever pondered over whether his legitimate commissions are enough to leave him with a margin of profit after all expenses are paid?

5. Presuming you have dealt in stocks on margin have you ever been annoyed over the delay in the settlement of your account and over the delivery of the stocks you have bought?

6. Do you know what bucketing orders is? Do you know that it is taking your orders and money for the purchase of stocks, not filling, *i. e.,* not buying them, and trusting, if you are one of the rare, lucky ones who is later in a position to demand their delivery, that they can be bought for less than you paid for them? Do you know this is illegal?

7. Have you ever thought whether your brokers, having bought, according to his notices to you and others, large numbers of shares of stocks for his customers, and on which he charges interest on the unpaid balances, has every share of these stocks in his pos-

session or actually on deposit against loans he may have secured on them?

8. Suppose every customer were to pay up on one day for every share of stock the brokers have notified them they have bought for their account, has it ever struck you to think whether they could all be delivered, and, if not, why?
9. Let us suppose every broker knowing bucketing is illegal fills by a bona-fide purchase in the market every buying order he receives by an actual purchase. Let us further admit the soundness of the broker's judgment that the public buys on a rising market and that the market must eventually drop. Is it certain that some brokers do not sell a large part of the stock they have bought for their *customers' account, and on which the customers should have an absolute lien,* with the view of buying them back at lower prices provided they have to make deliveries?
10. Short selling is not illegal. Is there anything to prevent a broker opening up one or more dummy accounts in his books in which will be entered all the sales he wishes to make?
11. Assuming these questions are pertinent to trading in securities is there any reason why they do not apply to trading on the exchanges in cotton, wheat, corn, etc.?
12. What do you really know about your broker?

Conclusions From the Preceding

a. Speculation in stocks on margin is risky.

b. Experience has proven that the percentage is greatly against the speculator.

c. The percentage increases rapidly against the speculator when he listens to the broker and applies his excess margins to the purchase of additional stocks.

d. No one, not even the wisest, ever knows the future trend of the market. In speculating on margin the speculator is staking his money, more often than not, against an absolute uncertainty.

e. The community does not benefit by such stock speculation on margin. It is in no way productive.

f. If you can afford it, the investment, by outright purchase and ample margining of stocks in legitimate development enterprises, will, if development is successful, benefit you and the community because of its production.

Copyright by Underwood & Underwood, N. Y.

CLEARING HOUSE, NEW YORK

CHAPTER VI

Observations On, and Facts Pertaining to Brokers and Margin Trading

In this time of acute conditions in the business and labor world, with the cost of every necessity of life at abnormally high figures, with the farmer, the manufacturer, the workman and the middleman demanding more and more, there is one outstanding suggestion reiterated as a sure means of lowering the cost of living—the suggestion "to increase production." This is a call to the producer to produce more in the same period of time in which he has hitherto produced less. I have not seen any suggestion to eliminate the non-producer or to turn his energy in directions that would be advantageous to the community.

Removal of Gambling Evils by Legislation

With the idea of removing certain evils the people of this country have forced their legislators to pass laws forbidding the holding of public lotteries for money prizes, the providing of public means to play cards, roulette, etc., for money, and betting on horse races. No one can claim that a person engaged in any of these occupations was a producer in the sense that he produced or provided a something that was a benefit to the nation—rather to the contrary. Being forced out of these non-producing occupations the majority engaged in them were compelled to apply themselves to other and more profitable ones for the community at large. It is conceded that gambling in any project in a way that it cannot produce a product necessary to the well-being of man-

kind is a detriment to the whole people. A thorough appreciation of that fact by the majority in the nation has been all that was necessary to bring about the needed legislation to suppress it. In no case has it been easy, because of the tremendous influence of those interested in the making of money by such means.

Losses in Cards, Roulette, On Horses, and in Margin Trading

Much has been said and written about those who have been ruined by cards, roulette and betting on the horses. Scant reference is made about those who have lost their all or more than they could afford in that most seductive form of gambling, "speculation on margin in stocks, securities, cotton, wheat, corn, etc.," and in this exists an evil as great as, or greater than, those which have been declared illegal. Millions of dollars are risked daily on the vagaries of the markets. At every great drop in prices thousands are seriously crippled financially or ruined because of the gambler's inability to be satisfied with a fair profit. Many wives know of their husbands', and many employers of their employees' propensity for playing a game of poker or their horse-racing betting proclivities who do not know of the risks they run and the losses they make in their so-called investments in stocks. It is an evil that is causing the misdirection and loss of untold millions of dollars that could well be utilized elsewhere. It hurts the many and benefits the few, and this result is principally due to the second class of brokers.

Bank Loans Necessary for Margin Accounts

"Under "A Few Suggestions in the Form of Questions," in Chapter V, bucketing is defined. Laws declaring this il-

legal are in effect, and were passed without having to surmount very great obstacles. In bucketing no one benefited except the broker. In margin trading the banks are practically forced to be interested through the necessity of making large loans to brokers. In the absence of legislation covering the matter it is impossible for the banks to differentiate between loans on securities that are real purchases—purchases made with the purpose of completing them when the money is in hand—and loans on securities bought on margin for purely speculative account. Following the established custom, vast loans have to be made daily to the brokers, and often at high interest rates. How can certain brokers pay that and charge the customer around six per cent on the unpaid balance on his stocks? Ponder over this.

Power of Banks and Use of Your Money

Not infrequently the banks, with a view to arresting great waves of stock speculation, deliberately put up the interest rates on call and time money to a very high figure, but since the war was over this did not appear to be the deterrent it should have been until call money was put up to 30 per cent. It is said that in the Federal Reserve Banks there is a centralization of power so great that, when it is considered advisable to arrest speculation on the Stock Exchanges, the interest rate on money needed to cover loans on securities can be put and kept so high that there is bound to be a cessation of the speculative craze and a consequent decline in the market quotations of stock. Naturally it is easy to deduce from this that the financial leaders who have the power can, if they be so inclined, avail themselves of their forehanded knowledge of the coming high price of money to make large profits by selling short in

the market (*i. e.*, speculating on a decline in prices of stocks), and, when securities have declined sufficiently, buy them in at the lowered prices and hold them for the next rise in prices when they can be re-sold to the public. Much of the money deposited in the banks all over the United States finds its way at certain seasons to New York, or, as they say in the west and in the farming districts, to "Wall Street." New York is the great financial centre and clearing house of the country. Your banker may be paying you 2, 3 or even 4 per cent. on your deposits. When he lends the money in his bank to New York it is, of course, for a higher rate of interest. The New York banker must, of course, secure a still higher rate. Millions of this money from your banks is used to finance loans made to brokers on stocks, cotton, etc., bought by the public on margin. The same thing applies to Chicago where the great trading in food products is carried on. It is a reasonable cause for wonder why one hears or reads so little detrimental to margin trading. Think it over. How much unseen powerful opposition would there be against an effort to limit margin trading by wise legislation? Undoubtedly such legislation would be of great benefit to the community.

Number of Brokers in New York

In New York City there are listed in the classified telephone directory, published in July, 1919, over one thousand four hundred stockbrokers, all of whom presumably deal in stocks, listed on the New York Stock Exchange, the Consolidated Stock Exchange of New York, or the New York Curb. Many of them are affiliated with other Stock Exchanges outside of New York. In the same directory, under the heading of "Investment Brokers, see also Stock Brokers," over eight hundred names are to be found. Some

of these are engaged solely in the outright sale of securities that are not listed on any of the exchanges, but many of them deal in listed securities on margin or otherwise. In addition there are the brokers who do business on the New York Cotton Exchange. A large number of the stockbrokers have connections with the Chicago Board of Trade and will accommodate you should you wish to speculate in such food necessities as wheat, oats, corn, pork, etc. In all of the large cities, and some of the small, all over this country thousands of brokers are to be found and many of the New York houses have branches elsewhere than in New York, some as many as twenty or thirty.

Size of Brokers' Establishments and Extent of Public Speculation

An idea of the extent to which the American public is speculating can be had by a consideration of the large number of brokers who must find it profitable to cater to its wants. A surprising number of these houses have scores of employes and in some cases the number of commissioned and salaried persons engaged by them runs into three figures. Magnificent suites of offices, in some cases whole floors in immense office buildings, show the prosperity that is theirs. A large part of this immense organization is maintained and supported by the speculative instinct of people whose speculations almost always mean losses and do no good to anyone except a few who, in the true sense, can be called unprofitable non-producers.

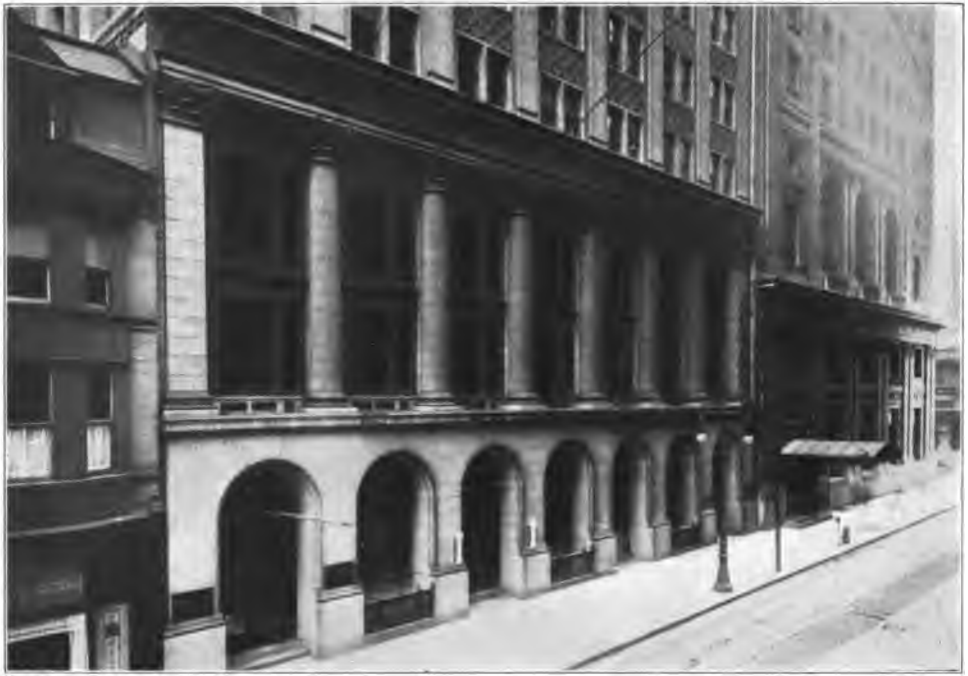
On the financial page of one of the New York newspapers published one year after the armistice was signed we find the following: "The turn in events which have been

> dominating influences in the stock market for the last week were not at all encouraging to-day. The

bank statement issued Saturday was highly favorable, as the intentions of the Federal Reserve Bank have been carried out. Loans showed a large decrease, while surplus reserves increased more than $40,000,000. But this increase is a small item when considering the fact that brokerage loans stand somewhere between *$1,500,000,000 and $1,700,000,000.* This expansion of credit has never been equalled in the history of Wall Street. While it is true that the country has more money than ever before, the credit expansion has been out of proportion in the large cities of the country, especially in New York and Chicago. The sluggish appearance of the stock market is now known throughout the country and persons who have paper profits have naturally become more or less worried. With the bear operators determined on revenge and factors surrounding the stock market bearing a rather unfavorable appearance, increasing liquidation has been the result. With the chimes of caution sounded by the Federal Reserve Bank, there has been a change of opinion brought about by small traders carrying long lines of stock. Many of these operators have had little experience in the stock market, knowing that during a bull market practically any stock will show a profit sooner or later. A majority of the 20,000,000 Liberty bondholders have become interested directly or indirectly in the stock market. The wide publicity given the bull movement has brought many new accounts into Wall Street. Now these newcomers are reading of an end to the bull move. Some brokerage houses are predicting that. This naturally has been responsible for a good deal of selling by small

investors who have no fear of tax collectors and are satisfied with their profits. Odd lot business has increased on the selling side. *While the check of the bull movement has not gone far enough to cause worry, it has brought traders to their senses, and they are beginning to realize that Wall Street and the stock market is a two-sided affair."*

There is only one criticism to be made on the above article, and it pertains to the last two words "two-sided affair." For the many of the margin speculators it is not a two-sided affair, it is one-sided—a losing affair. Why it is a losing affair has been explained under the paragraph headed "How your money is lost," in Chapter IV. They have pyramided their profits, and when the break came were unable to make up with hard cash the deficiency margin in their accounts. There is much food for thought in the statement that brokerage loans stand between $1,500,000,000 and $1,700,000,000. How much good is that nearly two billion dollars of tied-up money doing for the country?



Copyright by Underwood & Underwood, N. Y.

PHILADELPHIA STOCK EXCHANGE

To right, the Manufacturers' Club on corner Walnut and Broad Streets

CHAPTER VII

Stock Reforms Urged by Warburg

Paul M. Warburg, one of the greatest and cleverest American bankers, Chairman of the executive committee of the American Acceptance Council, in his report presented at the first annual meeting of that organization, December 4th, 1919, *characterized the call loan,* together with the Treasury certificate, as the two most serious obstacles preventing bankers' acceptances from attaining the position as the most desirable and most important asset among the so-called secondary reserves of banks. Mr. Warburg said, in part:

> "As long as this system continues, *as long as the banks all over the country dump their idle funds upon the stock exchange,* treating these stock exchange loans and New York balances invested therein as their quickest and most important secondary reserve, *just as long is the stock exchange in an unsound condition* and just so long will it be impossible to secure for our country the benefits of a wide discount market and effective bank rates.
>
> "For over ten years some of us have preached the gospel of a system of centralized reserve-banking predicated upon a reliable discount market, as against decentralized banking based upon reserves invested in stock exchange loans. Only the first part of this program has been carried into effect; the second part still remains to be accomplished. As long as the stock exchange call loans retain their prominence as secondary reserves of too many banks *and as long as stock exchange demands fix the call loan rate in the*

largest money centre of the world, we shall not enjoy a complete and perfect banking system. Nobody will deny that for a machine moving as fast and involving as gigantic daily transactions as the New York Stock Exchange, a change of system is a most difficult task. It is obvious that it should be undertaken only with the greatest possible precautions. But the difficulty should not scare us into inactivity and indefinite delay ***when we know that eventually the change has got to be made.*** When drastic banking reforms were first urged the most prominent bankers were opposed to it for the reason that they were prospering under the old system and because they thought that it would be impossible and dangerous to tinker with so immense and, at the same time, so delicate a structure. None the less, the system was remodeled without any serious disturbance and those were proved to have been right who predicted to prosperous bankers that if they could prosper with an unsafe system they would be certain to enjoy an even greater prosperity with a safe banking system. ***The same experience is in store for the stock exchange,*** but the question is: will they, of their own free will and initiative, undertake the task for their own benefit and ***that of the entire country,*** or will they delay as the banks did until they learned their lesson by the dread experiences of the panic of 1907 resulting in governmental legislation?

"At present, our gold position is well protected by a trade balance so phenomenally in our favor. In the long run, however, our country will not be able safely to accomplish its new task of a world

banker without the protection of an effective discount rate regulating a wide discount market.

"Our Stock Exchange must be protected from the vagaries of a daily fluctuating money supply; it should be placed on a basis of weekly or two-weekly settlements. *Our bill market should be protected from the daily unsettlement caused by the increasing and decreasing demands of the Stock Exchange.* The call money market ought to be based primarily on prime bills that can quickly be turned into cash balances, *while the bulk of undigested stocks and bonds ought to be carried by time loans rather than call loans.* As a matter of fact, many of these call loans are callable only in name, and inasmuch as they are carried by loans that are actually subject to call, they are a source of unrest and danger.

"The establishment of a world-wide discount market and its emancipation from *the evil influences of an unscientifically organized call loan market* is obviously a task still to be accomplished by us. No more useful work could be undertaken by the American Acceptance Council than to centre the attention of its members on this problem and to further its solution."

Inference From Mr. Warburg's Words Clear

Without a complete and perfect banking system the great commercial life of this country is bound to suffer unnecessarily. The inference from Mr. Warburg's words is clear. The enormous demand for so-called call loans on undigested securities, a large percentage of which securities are bought on margin for speculative purposes, and

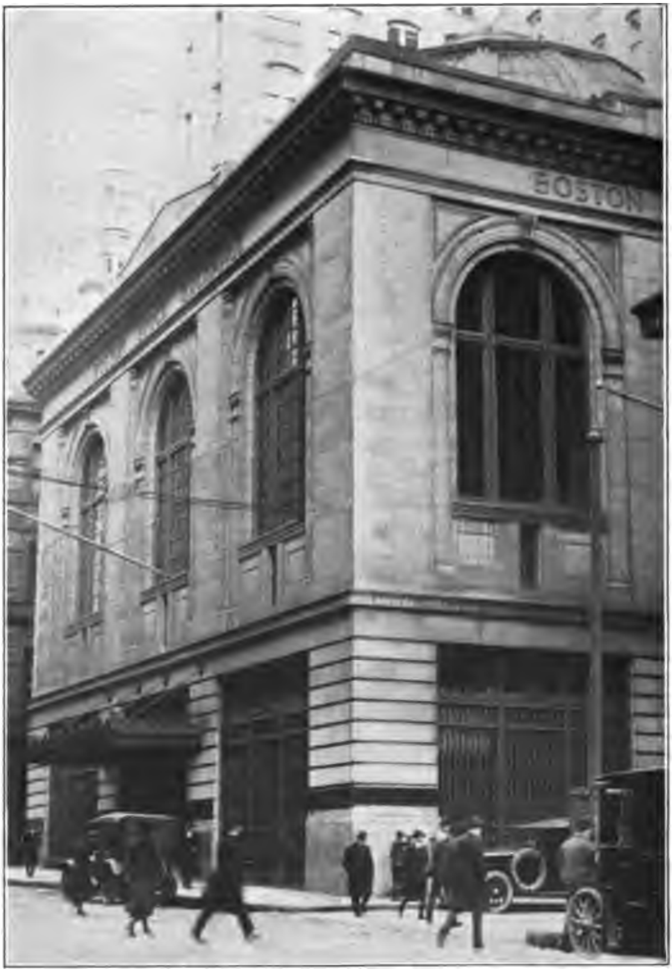
the treating of these loans as the banks' quickest and most important secondary reserve is a weakness in the banking system of this country and consequently a detriment and injury.

Federal Ball and Chain

A change in the system as intimated by Mr. Warburg would be incomplete if it is forgotten to put a federal ball and chain on margin trading and short selling of securities, cotton and food commodities somewhat along the lines indicated in the chapter entitled "In which a Remedy is Outlined."

Margin Trading Makes Possible High Prices for Food Commodities

Do the people of this country realize the immense quantities of cotton, wheat, oats and other food commodities, traded in on various exchanges, that are segregated in the great warehouses by margin-traders, who are themselves or through their brokers able readily to secure loans on them from the banks? Do they realize through this segregation of immense stocks, made possible under the system, a false scarcity is frequently created with its resultant higher prices? Do they realize that when these higher prices are reached the big margin-trader unloads and it is the public which pays the price? It is within the power of the public to correct this. If your senator and congressman really believe, and you can make them believe it, that you wish to be protected from such an abuse, *you will be protected.*



BOSTON STOCK EXCHANGE

CHAPTER VIII

The November Slump—A Case in Point

The November, 1919, heavy slump in the prices of securities on the various exchanges in the country attracted a great deal of attention. In this downward plunge of stock values thousands upon thousands of small traders on margin throughout the land lost heavily. The stock market had for some time been advancing by leaps and bounds and the public, blind as an avalanche coming down the side of a mountain, was rushing forward in its market speculation at a rate that was both dangerous and foolish. An avalanche does not stop until the bottom is reached, and the public did not stop until the bottom of the available money market brought them up with a round turn.

Public Does Not Heed Warnings

The public does not heed warnings, but the wise financiers did, with the result that the cautions of the Federal Reserve Board fell on deaf ears insofar as the average speculator was concerned. The big men knew there was a harvest coming to those who went short on the market, *i. e.,* played it for a decline in prices, which the public never does. Many lost their paper profits, their money and the stock they held. The far-sighted monied men who went short secured these stocks at attractive prices and, when the speculative public goes crazy again, will be glad to hand them over at a big profit, knowing full well that in time they can re-buy them at bottom figures. The public is slow in learning.

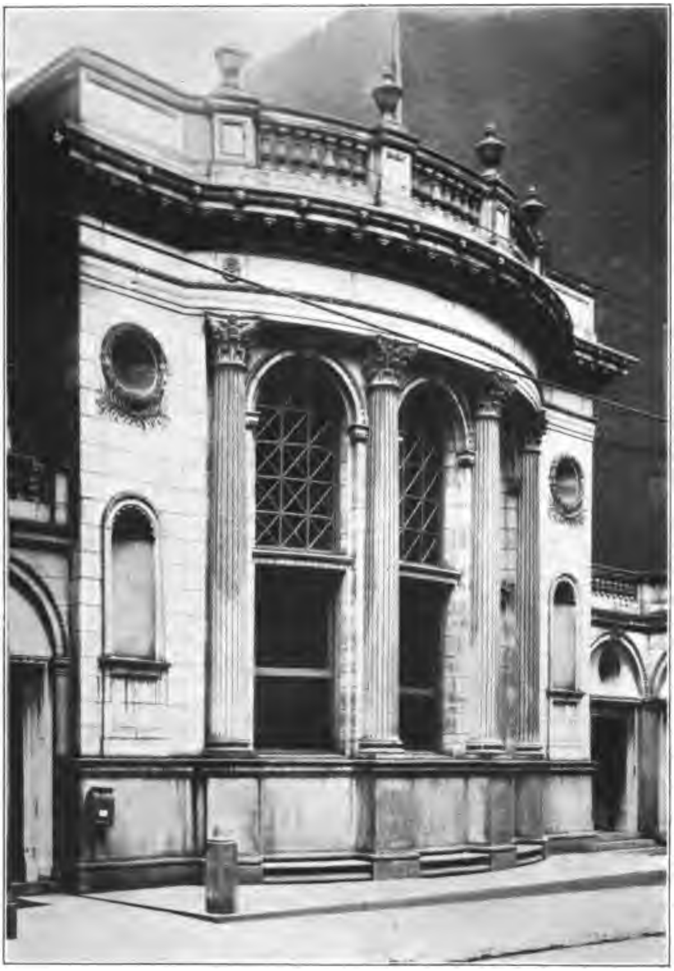
A Financial Harvest—Not the Public's

The second class of brokers previously referred to played their game with a view to the arrival of such a market slump. This was one of their harvest times, and the reaping was in the mowing down of the equities of the margin traders in the stocks they were carrying. It was a great harvest, but there was much weeping and gnashing of teeth among the stock margin speculators in every State of the Union. If the public would not gamble with these brokers on margin most of the reapers would have to go out of business.

Were You Properly Advised?

Ask yourself, if you were a margin speculator, one thing. Did your broker, who must have known of the rare and unusual market danger signal that was flying, the signal hoisted by the Federal Reserve Board regarding rates on call money, I suggest did your broker advise you to sell out your holdings and, provided you wished to speculate further, advise you to sell the market short? If he did not, why? The fact that he may have referred in his market-letters to the increases in the interest rates on call and renewal money means absolutely nothing if he did not advise you to sell. Not advising you to sell, did he have your best interests at heart, and if he did not have yours whose had he? Many brokers will claim that they suggested the selling of this, that or the other particular holding, probably adding a rider to the effect that in unloading the specified stock or stocks certain others looked good for profits and you would do well to take them on. Such partial advice means absolutely nothing. In the face of rising prices for money a decline in all stocks may be said to be inevitable.

Under such circumstances, the broker, keeping his weather eye open as he should for storms in which his customer's interests would be jeopardized, should have advised taking in all sail and battening down the hatches or, to put it plainer, advised the getting out of the market entirely or heavily protecting margin accounts with more money until the financial skies were once more clear. Who received such advice? Did you?



Copyright by Underwood & Underwood, N. Y.

PITTSBURGH STOCK EXCHANGE

CHAPTER IX

Federal Reserve Act With Reference to Speculation in Securities

The great and quick loss suffered by the speculative investing public through its gambling on margin in stocks, referred to in the preceding chapter, caused Senator R. L. Owen, of Oklahoma, to ask W. P. G. Harding, governor of the Federal Reserve Board, for a direct explanation of the price crash in listed securities. Governor Harding's reply to the Honorable Senator was illuminating.

Extracts From Governor Harding's Letter

The following extracts from Governor Harding's reply to Senator Owen are worth repetition:

> "The Federal Reserve Act is intended for the benefit of commerce and industry *and not for the stimulation of the investment market or of speculative movements.* The short title of the act reads as follows: 'An act to provide for the establishment of Federal Reserve Banks, furnish an elastic currency, to afford means of re-discounting commercial paper, to establish a more effective supervision of banking in the United States.'
>
> "Section 13 of the act, provides, in part, that Federal Reserve Banks may discount notes, drafts, and bills of exchange arising out of actual commercial transactions: That is, notes, drafts, and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes, or the proceeds of which

have been used, or are to be used for such purposes. It provides, further, that nothing contained in the act shall be construed to prohibit such notes, drafts, and bills of exchange, secured by staple agricultural products, or other goods, wares or merchandise from being eligible for such discount '*but such definition shall not include notes, drafts, or bills covering merely investments or issued or drawn for the purpose of carrying or trading in stocks, bonds, or other investment securities,* except bonds and notes of the Government of the United States.'

"The Board has repeatedly called attention to the fact *that resources obtained from the Federal Reserve Banks should not be used for speculative purposes,* and at various times when there has been unusual speculative activity, it has issued public warnings as to the bad effect of such activities upon the banking situation.

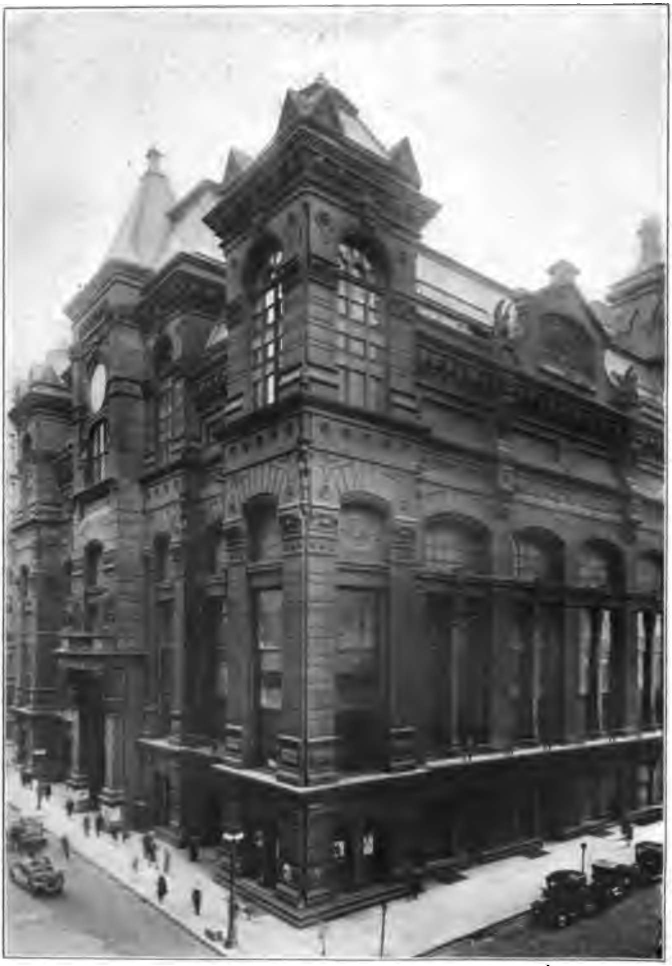
"The high rates for call money which have prevailed continuously for the last two weeks, and intermittently for several months past, were in themselves very clear indication of the strained position into which the unabridged speculation had thrown the stock market and rendered a readjustment inevitable unless the resources of the Federal Reserve Banks were to be indirectly drawn upon for stock market purposes. *The public has had ample notice of the board's policy.*"

Government's Recognition of Non-Usefulness of Stock Speculation

The above statements in the Governor's letter with quotations from the Federal Reserve Act pierce like a high-

powered searchlight the Stygian blackness of the sea of stock market speculation on margin. To say the least they indicate an acknowledgment on the part of the United States Government that no encouragement in a monetary way should be given by it through its greatest financial institution to speculation in investment securities. It is an indirect recognition of the fact that the government will not be a party to stock market gambling. Why not have included trading in cotton and food commodities on margin for speculative purposes? Why not protect the public that gambles on margin against itself by preventing the loss of its money in an absolutely non-productive channel?

In the following chapter the writer ventures to make suggestions of legislation which, if put into effect, would undoubtedly remove a source that permits unbridled gambling and causes much suffering and great loss of useful time and energy the country can ill-afford.



Copyright by Underwood & Underwood, N. Y.

CHICAGO BOARD OF TRADE

CHAPTER X

In Which a Remedy Is Outlined

It has been previously stated that the New York Stock Exchange and others similar to it, serving as a medium for the legitimate buying and selling of stocks, securities and commodities, such as cotton, grain, etc., are a public necessity. These institutions are an essential and an integral part of our great financial and commercial life. Their utilization for the proper purposes for which they were created cannot be criticized, but when the uses of public or quasi-public institutions are diverted to the exploitation and development of proceedings that, in their sum, cause an injury to a considerable section of the public then steps should be taken to control them in this particular direction.

Margin Speculation in Food Commodities

Marginal speculation in food commodities by those whose only desire is to make a profit on the increase or decrease in the market quotations is apt to create false price conditions not at all beneficial to the users of these foods.

Marginal Trading in Securities a Perversion of Just Uses of Stock Exchanges

Whilst the trading in stocks and securities on margin does not so directly affect the home, it is a perversion of the just uses for which Stock Exchanges handling their buying or selling were intended.

Number of Brokers too Great for Country's Good

The number of brokers in the country is much greater than perfectly legitimate transactions call for. Were the suggestions indicated later put into legal effect the great majority of them would be put out of business and obliged to devote their brains and energies in directions more profitable to the nation.

Suggested National Legislation

In the opinion of the writer national legislation along the following lines would remedy the defects now existing without detriment to the useful purpose of the exchanges.

Food Products and Cotton

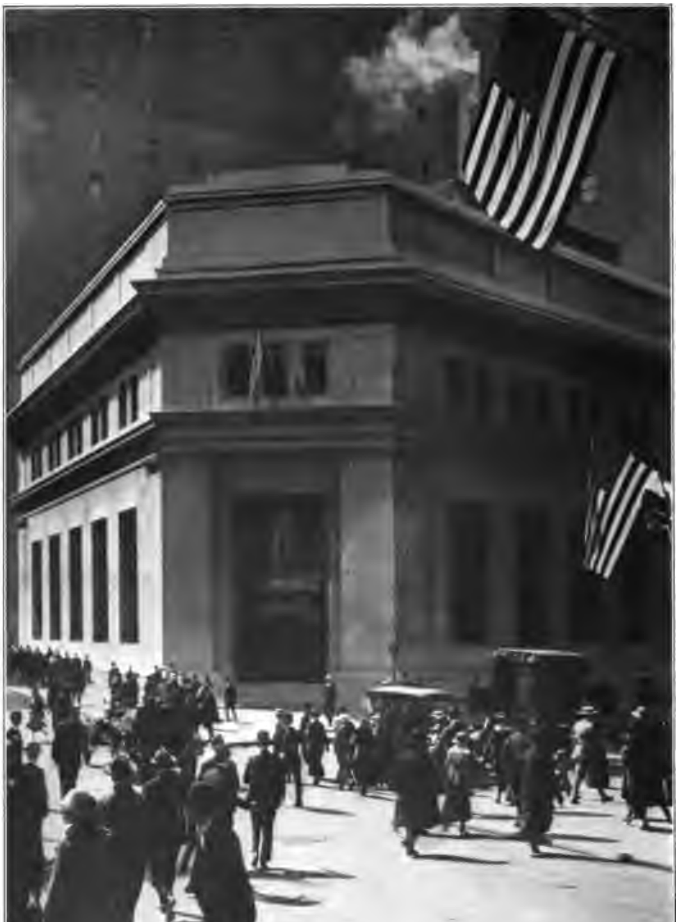
1. Make it unlawful to trade in food products and cotton through the exchanges on margin.
2. Make it unlawful for an exchange or member of an exchange to buy or sell food products or cotton for those who do not buy with the intent of taking actual delivery and who sell that which they have not actually in their legal possession, and the exchange or broker should be compelled to ascertain definitely that the buyer's position is one that will justify belief in the intent to take delivery and that the seller has actually in his legal possession the commodity he desires to dispose of.

Stocks and Securities

3. Compel every broker to fill by actual purchase, and to have in his possession or on deposit in some recognized financial institution as collateral for

loans not exceeding the amount actually due him by his customers, all stocks and securities that he has bought for the account of his customers on their written order and of which purchases, when made, he has notified the buyers.

4. Declare it illegal for any broker to loan any part of stocks or securities that he has purchased for the account of a customer to another broker, individual or institution.
5. Make it unlawful for any broker to sell short any stocks or securities that he has purchased on customers' account.
6. Make it unlawful for any individual or institution to sell short any stocks or securities of which they have not actual legal possession, and for any broker to sell short such stock or securities until they have been delivered into their hands and to be retained intact by them on account of each particular transaction until it is consummated.
7. Make it unlawful for any broker to ask any customer and for any customer to sign an agreement (as is the custom) giving the broker power to lend, pledge or use securities bought or received on the customer's account. Limit the agreement between the broker and customer to granting the broker the right, if he finds it necessary, to put up the securities carried in a customer's account as collateral for a loan from some recognized financial institution for not more than the amount due by the customer to the broker.



Copyright by Underwood & Underwood, N. Y.

NEW BUILDING, J. P. MORGAN & CO., CORNER OF WALL AND BROAD STREETS

CHAPTER XI

Speculation Inherent and an Outlet for the Speculative Investor

It is inherent in man to speculate and to gamble. From the cradle to the grave the human being is taking and has to take chances. He cannot be blamed for taking risks because the desire is a primal one. Columbus and his crew, despite his belief and their faith in him, were hazarding everything in their first voyage of discovery westward. The Pilgrim Fathers, who landed at Plymouth Rock, placed themselves in the hands of God. Lewis and Clark, in their first voyage up the Missouri and thence westward with those other founders of Astoria, trusted to fate that all would be well. The early farmer pioneers, in their gradual encroachment on the west, gambled with both life and substance. Those hardy men who risked their all in their efforts to reach California, when first gold was discovered there, could not be called conservative. The first great railroad builders of this country had unbounded confidence in their star and their land and did not hesitate to venture to the limit. This United States is what it is to-day because there was in the blood of the fore-fathers a gambling, venturesome spirit that was not afraid to take any number of chances. The great wealth of the country is due to that spirit coupled with an ability to work hard and an imagination that saw the riches in the unknown land above, in and below the ground. They all suffered, many went broke, many died, but wealth came to many of them and to the great communities of which they are a part.

Differences in Gambling or Speculation

Gambling is inherent and will continue. There is a vast difference in the results from different kinds of gambling. The contrast between those referred to in the preceding paragraph and the individual who gambles through margin trading on a turn in the market is almost too great for comparison. The former have the thanks and appreciation of the whole people for the good that has resulted from their taking such risks. The latter, well, the less said about them the better; they seldom benefit themselves, but always the broker, and they almost invariably hide from their families, associates and friends the fact that they speculate in stocks on margin. Why?

People Must and Will Take Financial Risk

It is an impossibility to attempt to stop most individuals from incurring some kinds of financial risk. Legislation cannot do it, but legislation can prohibit by declaring unlawful the taking of risks that practice has demonstrated cannot possibly do any good to the public generally, but, on the contrary, directly and indirectly, do harm.

A Right Kind of Speculation

There are many excellent, capable, wealthy gentlemen in this country holding positions of prominence, themselves safeguarded from all reasonable financial want, who feel called on every now and then to advise the people against all kinds of speculation. As well advise the tides not to rise and fall. It would be far better were they to suggest that when people wish to speculate with the hope of unusual gain they should do so in some such direction as the purchase of stocks in development ventures having for their

object the manufacture of a new product or the exploitation and utilization of natural resources which the reports of experts indicate have favorable chances of becoming profitable. Although such speculation is slower, it is surer in its results and is justifiable because, when successful development brings gain, there is the secondary satisfaction of having helped to create new wealth from which the country benefits.

Protect Speculative Investor and Encourage the Pioneer

Enact reasonable legislation to protect the speculative investor in legitimate development opportunities. Permit the pioneer and the organizer to reap a handsome reward for their work, energy and foresight. They deserve it because they are creating new wealth, opening up resources that would lie dormant without them. Encouragement to these people leaves open a fruitful channel for speculation to the American citizen, whose inherited and inalienable right it is, in a way that can be productive of satisfactory results to the world as a whole.

Logical Conclusion of Advice Not to Speculate, and Result if Heeded

The advice of leaders of finance to the people never to take risks would, carried to its logical conclusion, keep wage-earners always wage-earners, because no new business would ever be opened up, no new enterprises started, except by those who have more than they need, and wealth would corral all the opportunities from which it would reap the greater profits, and then let the less fortunate buy the securities when they have been boiled down to a 5 or a 6 per cent. basis.

Big Financiers Avail Themselves of Margin Trading

It is well recognized among financiers and brokers that the public always carries the bag. Many of these shrewd, far-seeing financiers, with their great means, always avail themselves of the margin method of speculation to reap great profits from the downward and upward swings of the markets. Having a *real* knowledge of the intrinsic values of securities, they buy when market values decline. Having ample means at their disposal, and not being so subject to the suggestions of brokers to margin up to the limit, they are prepared to carry their holdings over long periods. The result is that when the market reaches the top and the public is buying like mad (on margin) they unload on the unsophisticated and smile grimly. The man with a few hundreds or thousands has no chance in this game. He might as well bet on pulling blindly the ace of hearts out of a pack the first, second or third try. The ace to all intents and purposes, insofar as the final results are concerned, might just as well be up the dealer's (broker's) sleeve.

Copyright by Underwood & Underwood, N. Y.

LOOKING UP WALL STREET FROM TOP OF No. 65

Roof left foreground, National City Bank; pyramid roof in centre, Bankers' Trust Building; large double structure to right is the Equitable, 120 Broadway, the largest office building in the world

CHAPTER XII

Discriminating Articles Against Stock Promotions

One reads frequently in the newspapers and magazines long articles on stock promotions, particularly in oils and mines. Able writers are paid large sums to expose the methods of those who would fleece the public with fake schemes. The general trend of their writings is to discourage and prevent the unwise and unwealthy from purchasing any security that has not been passed on by the leaders in finance. Some of them have indicated that as much as 500,000,000 dollars is taken from the public annually in this way. How they arrive at these figures is hard to guess. Why the emphasis on this phase of speculation which, in worthy, honest forms, can benefit the country, and the practical ignoring of a greater and more pernicious one?

Stock Brokers Not Mentioned

In an article entitled "Don't Speculate and Don't Listen to Tips on Stocks," written by one of the great leading bankers of the country, and published in one of the leading magazines, he frowns down on the purchase of speculative oil and mining stocks and advises the reader to "leave such gambling to those who think they can afford losses." In reality it is very few who think they can afford losses, even the very wealthy. They almost always want more. Despite all that may be said to the contrary, the acquisition of wealth is, more often than not, accompanied

by the element of risk. If the wealthy men of the country (except those who inherited it) were to tell the exact truth in connection with the accumulation of their wealth it would probably be found that there were times when they took the risks, and big ones they could not afford, which they now advise others against. The writer of the article mentioned above *does advise against the purchase of stocks on margin,* and rightly too, but, whilst he devotes space to promoters of oil and mining stocks, he does not say one word about certain kinds of stock brokers who take and encourage accounts on margin.

A Real Question and a Big Red Herring

Why always the emphasis on stock promotions? Why never an emphasis on the necessity of doing away with or limiting, as heretofore indicated, trading on margin? Is it a "Great Big Red Herring" thrown across the trail? The financial institutions do not benefit by the outright sale of original development securities, but they do get a big interest return on millions upon millions of dollars loaned to brokers for the purpose of carrying securities on margin.

3,500 Brokers—Over One Billion Dollars

Let us make a rough comparison and assume that there are 3,500 stock, grain and cotton brokers in the country who will carry accounts on margin. Let us estimate that they average only $1,000 per day in remittances on margin account. Some days the big ones run into six figures, and the smaller ones less. Take 300 working days in the year. *Multiply $1,000×3,500×300=$1,050,000,000. Over one*

billion dollars—an immense sum for speculating, gambling on margin.

? ? ? ? ?

It looks as though the big brother who does not do a thing to add to the development of the natural resources of the country is putting it all over the little brother. Doesn't it? Think it over.

THE END

All the italics in the book are the writer's.